

Before the
Illinois Commerce Commission
Docket No. 04-0294

**AMEREN CORPORATION AND
ILLINOIS POWER COMPANY**

Rebuttal Testimony

of

Michael Gorman

On behalf of

Illinois Industrial Energy Consumers

Project 8191
August 2004



BRUBAKER & ASSOCIATES, INC.
ST. LOUIS, MO 63141-2000

Before the
Illinois Commerce Commission
Docket No. 04-0294

AMEREN CORPORATION AND
ILLINOIS POWER COMPANY

Index

	<u>Page</u>
NON-UTILITY SUBSIDIZATION	2
REGULATORY ASSET	12
CAPITAL STRUCTURE	17

Before the
Illinois Commerce Commission
Docket No. 04-0294

**AMEREN CORPORATION AND
ILLINOIS POWER COMPANY**

Rebuttal Testimony of Michael Gorman

1 **Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A My name is Michael Gorman. My business address is 1215 Fern Ridge Parkway, Suite
3 208, St. Louis, MO 63141-2000.

4 **Q ARE YOU THE SAME MICHAEL GORMAN WHO HAS PREVIOUSLY TESTIFIED IN**
5 **THIS PROCEEDING?**

6 A Yes.

7 **Q WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

8 A I will respond to the rebuttal testimony of certain Ameren and Illinois Power (together
9 referred to as the Applicants) testimony in this proceeding. The issues discussed in the
10 Applicant's testimony to which I will respond include deferred tax balances, regulatory
11 assets, and the hazardous materials adjustment clause ("HMAC rider").

12 **Q PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.**

13 A In their rebuttal testimony, the Applicants have failed to credibly respond to the
14 arguments I set forth in my direct testimony that support my position that the transaction

1 must be restructured before the Illinois Commerce Commission (Commission) approves
2 Ameren's proposal to acquire Illinois Power Company (IP).

3 As set forth in my direct testimony, the Applicants' current proposed
4 reorganization will result in the following inappropriate consequences to IP's retail
5 customers:

- 6 1. The proposed reorganization will result in the unjustified subsidization of non-utility
7 activities at great expense to IP's retail customers.
- 8 2. The proposed reorganization will result in adverse rate impacts on retail customers.
- 9 3. The proposed reorganization is likely to have a significant adverse impact on
10 competition in both IP's service territory and throughout the state of Illinois.

11 **NON-UTILITY SUBSIDIZATION**

12 **Q WHICH OF THE APPLICANTS' WITNESSES ADDRESSED ISSUES RELATED TO**
13 **THE SUBSIDIZATION OF NON-UTILITY ACTIVITIES?**

14 **A** Issues that create subsidization of non-utility activities include the elimination of deferred
15 income taxes establishing the rate base for IP's delivery services. Applicants' witness
16 Warren Baxter addresses this issue. As described in response to the Applicants'
17 witnesses below, the elimination of deferred taxes creates significant negative rate
18 impacts to retail customers in order to enhance Ameren's expected acquisition return
19 and to meet Dynegy's demanded sale price.

20 Further, implementation of an HMAC rider inappropriately assigns all of the
21 Applicants' asbestos litigation-related expenses to IP's retail transmission and
22 distribution (T&D) utility customers. This is significant because these expenses have not
23 been shown to be properly recovered from retail utility customers. Further, the asbestos
24 litigation expense that would be passed through the HMAC is related to activities
25 conducted at IP's previously owned generating facilities. These generating facilities are

1 now non-utility competitive operations that no longer are part of IP's regulated utility
2 operations. Therefore, implementation of the HMAC rider will assign all of the costs and
3 risks associated with asbestos litigation to IP's utility operations and completely eliminate
4 IP's risk of recovering the asbestos litigation cost from IP's non-regulated assets and
5 earnings.¹ Consequently, the HMAC rider will cause regulated utility operations to
6 subsidize IP's non-utility, i.e., competitive, operations.

7 **Q DID AMEREN WITNESS WARREN BAXTER ADDRESS THE DEFERRED TAX ISSUE**
8 **IN HIS REBUTTAL TESTIMONY?**

9 A Yes. Mr. Baxter responds to my testimony where I stated that the elimination of deferred
10 taxes has significant negative rate consequences to Illinois Power utility customers. In
11 response to this testimony Mr. Baxter makes the following points.

- 12 1. Mr. Baxter argues that there are no options with respect to the change in deferred
13 tax balances because this transaction is being treated as an asset sale for federal
14 income tax purposes under Section 338(h)(10) of the Internal Revenue Code. With
15 this treatment, IP's deferred tax balances are eliminated from its books at closing.
16 Mr. Baxter asserts that the parties could not agree to a transaction on any other
17 basis other than a Section 338(h)(10) election (Applicants' Exhibit 21.0 at 5-7).
- 18 2. Mr. Baxter also argues that it is not realistic to assume that there is a painless
19 means of restoring IP to its full financial health. He argues that I have made an
20 assumption that under continued Dynegy ownership IP's revenue requirement
21 would be static and there would be no realistic scenario under which IP's customers
22 would face any cost of service impact (id. at 6).
- 23 3. Finally, Mr. Baxter asserts that Ameren is paying \$2.175 billion to acquire IP with a
24 book value of assets of \$1.9 billion. He asserts that Ameren would view any
25 approval condition that limited its rate base to the pre-closing level of \$1.6 billion as
26 materially adverse to its interests and Ameren would not close. In sum, he argues
27 that Ameren would not pay \$2.175 billion for a company with a \$1.6 billion rate base
28 (id. at 7).

¹ IP's current non-regulated earnings are produced from interest income received from its affiliate loan with Dynegy.

1 **Q PLEASE RESPOND TO MR. BAXTER'S TESTIMONY.**

2 A Mr. Baxter's points relate to the investment return demanded by Ameren to acquire IP,
3 and the price demanded by Dynegy to sell IP. I don't question whether the parties have
4 a right to set investment return requirements. However, Mr. Baxter's arguments simply
5 do not address the important retail ratepayer protections that should be addressed in
6 determining whether this transaction is in the public interest. There is no doubt that
7 Dynegy wants to get the highest price (and after-tax value) it can for selling IP to
8 Ameren, and there is no doubt that Ameren wants to get the highest return it can
9 achieve by making this investment. Unfortunately, protecting the public interest is not
10 tied to Dynegy's price demands nor to Ameren's required investment returns. Rather, it
11 should be based on rate impacts created by the proposed acquisition. If the proposed
12 terms and conditions of the transaction and asset sale do not provide adequate
13 customer protection, then the Commission should reject the transactions unless the
14 terms and conditions are modified.

15 Second, Mr. Baxter's assertion that there are no painless means of restoring IP
16 to its full financial health does not support the reasonableness of the proposed
17 transaction. Importantly, the Commission should not approve a reorganization that is in
18 conflict with the public interest.

19 **Q MR. BAXTER SUGGESTED THAT IT IS YOUR POSITION THAT THERE IS NO**
20 **PAINLESS MEANS OF RESTORING IP'S FINANCIAL HEALTH. WAS THAT YOUR**
21 **TESTIMONY?**

22 A No. Clearly, there is a benefit to restoring IP's credit standing to investment grade. But,
23 that doesn't support the onerous terms of the proposed transaction. It is my position that

1 the price and terms demanded by Dynegy, and Ameren's demand to pass the cost of
2 Dynegy's demands onto retail customers adversely impacts the public's interests.

3 I strongly encourage the Commission to look at the balance of equity within this
4 proposed transaction. Dynegy is demanding certain prices and tax treatment of the
5 proposed transactions which significantly increase IP's cost of service. Ameren is not
6 willing to assume the higher costs created by Dynegy's demands. Consequently,
7 Ameren is demanding that customers assume these higher costs required by Dynegy's
8 price demands as a condition to close the sale. I recommend the Commission reject
9 Dynegy's pricing terms and sale demands as not in the public interest. Consequently, if
10 Dynegy modifies its sale terms and conditions such that Ameren does not demand such
11 onerous price implications for retail customers, then the deal could be structured in such
12 a way that the public interest would be protected. The current deal does not protect
13 customers' interests and therefore the reorganization as proposed should be rejected
14 unless certain terms and conditions are modified.

15 **Q SHOULD THE COMMISSION ACCEPT THE TERMS AND CONDITIONS DEMANDED**
16 **BY AMEREN AND DYNEGY IN ORDER TO IMPROVE IP'S CREDIT STANDING TO**
17 **INVESTMENT GRADE?**

18 **A** No. The Commission should exercise its authority to protect the public interest by
19 demanding modifications to the proposed deal to eliminate all adverse ratepayer
20 impacts. The Commission should not perceive this as a take it or leave it deal, because
21 selling IP has significant value to Dynegy. Therefore, Dynegy has an incentive to
22 complete the transaction even if modifications are made.

1 Importantly, as noted above, Ameren and Dynegy have negotiated terms that
2 maximize benefits to their shareholders. The Commission must demand terms that
3 protect customers and balance all stakeholders' interests, not just shareholders.

4 **Q DOES DYNEGY HAVE THE FINANCIAL STRENGTH TO SUPPORT IP IF THE SALE**
5 **IS DELAYED TO ACCOMMODATE DEMANDS MADE BY THE COMMISSION?**

6 A Yes. In a new release announcing Dynegy's second quarter 2004 results, dated July 28,
7 2004, Dynegy stated that restructuring efforts were highlighted by implementation of a
8 new \$1.3 billion credit facility which strengthened its liquidity at \$1.4 billion. Dynegy had
9 in previous years been losing money, but announced a positive earnings guidance for
10 calendar year 2004. Accordingly, Dynegy's liquidity and earnings prospects are
11 improving.

12 Dynegy has an incentive to support IP's operations through affiliate loans and
13 other means, in order to protect and enhance the value of IP's equity capital. Indeed,
14 Ameren is proposing to pay \$500 million for Dynegy's equity ownership in IP. If Dynegy
15 does not support IP, it faces significant risk that the value of IP's equity will be severely
16 eroded.

17 **Q WHY DO YOU CONTEND THAT SELLING IP IS IMPORTANT TO DYNEGY?**

18 A Dynegy has announced its intent to sell IP and reduce its significant debt obligations,
19 strengthen its balance sheet, and cash coverage of debt obligations. Therefore,
20 Dynegy's has a significant economic interest in protecting IP's value to maximize its
21 benefit of selling IP. Indeed, by selling IP, Dynegy will reduce its total maturity debt
22 obligation in 2004 of \$6.1 billion by \$1.9 billion, the amount of IP's debt transferred to

1 Ameren.² Also, Dynegy can use the IP equity sales proceeds to pay down debt. Under
2 the proposed deal, Ameren has agreed to pay Dynegy \$500 million for its equity
3 ownership in IP, of which \$400 million, pre tax, would be available to pay down Dynegy's
4 debt, immediately.

5 Also, it is in Dynegy's interest to sell IP and eliminate the affiliate loan obligation
6 as soon as possible. Dynegy currently pays in excess of \$170 million of annual interest
7 to IP under the affiliate loan. To the extent Dynegy's ability to sell IP is put off, Dynegy
8 will incur \$170 million of affiliate loan expense for every year the sale is delayed. Hence,
9 selling IP and eliminating the affiliate loan has significant value to Dynegy.

10 Finally, Dynegy states that selling its non-core assets, including IP, is key to
11 meeting its future liquidity:

12 "As of May 3, 2004, we had cash on hand of \$438 million
13 and available borrowing capacity of \$887 million, for total
14 liquidity of \$1.3 billion. Our ability to maintain our liquidity
15 position in the future will depend on a number of factors,
16 including our ability to consummate non-core asset sales,
17 including the Illinois Power sale to Ameren, and over the
18 longer term, to generate cash flows from our asset-based
19 energy businesses in relation to our substantial debt
20 obligations and ongoing operating requirement." (Dynegy
21 SEC Form 10-Q, March 31, 2004 at 31-32) (Emphasis
22 added)

23 Clearly, the timely sale of IP is important to Dynegy.

24 **Q WHAT TERMS AND CONDITIONS OF THE PROPOSED REORGANIZATION**
25 **SHOULD BE MODIFIED?**

26 **A** The biggest cost of service impact under the sale terms and conditions is created
27 by the elimination of IP's accumulated deferred income tax which is caused by Dynegy's

² Dynegy's March 31, 2004 SEC Form 10Q at 31-32, and Dynegy 2004 North American Energy & Power Conference, Boston Massachusetts, June 7, 2004.

1 demand for the Section 338(h)(10) election. Further, the elimination of deferred income
2 taxes appears to be important to Ameren because, as Mr. Baxter states, Ameren would
3 not have paid \$2.1 billion for a utility with a rate base of \$1.6 billion. By elimination of
4 accumulated deferred income taxes, Ameren is able to increase IP's rate base from \$1.6
5 billion, up to \$1.9 billion.

6 Eliminating IP's deferred income taxes significantly increases IP's cost of service.
7 If Dynegy were to modify its demands for a Section 338 election, IP's accumulated
8 deferred income taxes would not be eliminated, and the public interest standard would
9 likely be protected because adverse rate impacts would be mitigated or eliminated.

10 Importantly, Ameren agreed that if Dynegy had not demanded a 338(h)(10)
11 election, and the transaction had been treated as a stock sale for income tax purposes,
12 then IP's accumulated deferred income taxes would not have been eliminated. Further,
13 Ameren has estimated that Dynegy's demand for a 338(h)(10) election will reduce its tax
14 obligation under the sale transaction by approximately \$24 million (Ameren Response to
15 IIEC 4-4). Consequently, the Commission should not approve the proposed transaction
16 unless modified to preserve IP's deferred tax balance.

17 **Q PLEASE SUMMARIZE THE APPLICANT'S TESTIMONY CONCERNING THEIR**
18 **REQUIREMENT TO IMPLEMENT AN HMAC RIDER.**

19 **A** At Page 10 of his rebuttal testimony, Mr. Baxter explains that the current and anticipated
20 future asbestos claims are largely due to workers exposure while working at generating
21 plants owned by IP prior to 2000, and IP has retained the liability for asbestos claims
22 during the period it owned generating assets. He asserts that Ameren will not have an
23 ownership interest in these generating plants and it will not have an opportunity to
24 mitigate the asbestos exposure claims with a generation asset acquisition.

1 Mr. Baxter maintains that the economic risk associated with IP's asbestos liability
2 is materially adverse for Ameren. He argues that the purchase price does not
3 adequately compensate Ameren for taking this asbestos litigation risk.

4 Since Dynegy was demanding a certain price for IP, he argues that Ameren's
5 only means to mitigate this risk exposure was to make the HMAC rider a condition of
6 closing the transaction. He concludes that if the HMAC rider is not approved in
7 substantially the form proposed by the Applicants, that Ameren believes it is not required
8 to consummate the transaction.

9 Further, Applicants' witness Steve Sullivan goes over details of Ameren's
10 perceived risk of asbestos litigation costs that would be recovered through the HMAC
11 rider. Mr. Sullivan also addresses other means in which Ameren considered in order to
12 mitigate the asbestos litigation risk. Based on his assessment, he believes that the
13 HMAC rider is the best means of mitigating Ameren's asbestos litigation risk under the
14 proposed transaction. Mr. Sullivan also explains that Ameren is not willing to assume
15 IP's risk of asbestos litigation cost and therefore implementation of a rider substantially
16 in the form proposed by the Applicants is necessary to close the deal.

17 **Q HAVE THE APPLICANTS' WITNESSES JUSTIFIED THE IMPLEMENTATION OF AN**
18 **HMAC RIDER IN THIS PROCEEDING?**

19 **A** No. The Commission should require the Companies to modify the terms of the
20 acquisition to remove the requirement for implementation of an HMAC rider. An HMAC
21 rider should be rejected for the following reasons:

- 22 1. The Company has not demonstrated that the costs that would be recovered through
23 the rider are material, volatile, and inhibit the Company's ability to earn its
24 authorized return on equity. Consequently, the asbestos litigation expense does not
25 justify a rider recovery mechanism. I address this in my direct testimony.
26

- 1 2. The asbestos litigation expenses are not properly recoverable from transmission
2 and distribution utility customers. The Applicants' witnesses make clear these
3 asbestos claims are related to IP's previous ownership of generation assets.
4 Therefore, these costs should be recovered from the mechanisms available to IP to
5 recover its generation-related costs.
- 6 3. Recovering the asbestos litigation expenses, which are affiliated with non-regulated
7 competitive operations, from retail customers will create inappropriate subsidies for
8 these competitive operations by increasing charges to retail customers. This
9 proposal will cause retail customers to subsidize IP's regulated or competitive
10 business operations.

11 **Q PLEASE DESCRIBE THE MECHANISMS AVAILABLE TO IP TO RECOVER THE**
12 **COST OF ITS PREVIOUSLY OWNED GENERATING ASSETS.**

13 A Currently, IP has two mechanisms to recover non-regulated generation-related costs.
14 First, IP transferred its fossil fuel generating assets to Dynegy in exchange for an affiliate
15 loan. Dynegy currently is making interest payments on that affiliate loan agreement,
16 which matures in 2009. IP records this interest income below the line, i.e., separate
17 from utility income. Therefore, IP's earnings and cash flow are enhanced by its previous
18 fossil generating assets through its affiliate loan agreement with Dynegy.

19 Second, the vast majority of customers (99.8%) pay bundled rates that include
20 IP's former generation costs. Also, it's my understanding that during the Mandatory
21 Transition Period for those customers that elect delivery service, transition charges are
22 implemented in order to ensure that a substantial portion of the utilities' lost margins are
23 retained, in an effort to permit utilities to recover the cost of generating assets (including
24 asbestos-related costs) that may not be recoverable otherwise. Consequently,
25 customers are already providing assurance that IP will have the opportunity to recover
26 its generation-related costs through bundled rates and the transition charge mechanisms
27 built into the Mandatory Transition Period.

1 It is important to note that without the base rate freeze during the Mandatory
2 Transition Period, it is very likely that IP's cost-based generation prices would have
3 declined considerably during the Mandatory Transition Period. Customers have
4 foregone a decline to the cost-based generation prices during the Mandatory Transition
5 Period, in exchange for providing the Company an opportunity to recover all generation-
6 related costs. Hence, transmission and distribution customers should no longer be
7 responsible for any of IP's former generation-related costs after the end of the
8 Mandatory Transition Period.

9 **Q HOW DOES THE PROPOSED TRANSACTION CHANGE IP'S ABILITY TO FUND**
10 **ASBESTOS LITIGATION COSTS?**

11 **A** Asbestos litigation expenses now could be paid out of profits from IP's affiliate loan with
12 Dynegy. If that affiliate loan is eliminated as is proposed under this reorganization, then
13 IP's only source of cash flow and earnings will be produced from T&D operations.
14 Therefore, the proposed transactions eliminate a financial arrangement that protects
15 retail T&D customers from paying asbestos litigation expenses. Consequently, the
16 Commission should make as an additional condition for its approval of the transaction (in
17 addition to Dynegy's willingness to eliminate the Section 338(h)(10) election, as
18 described above), a requirement that either Ameren will assume responsibility for all
19 asbestos litigation expense, or a requirement that a sufficient amount of funding be set
20 aside in order to provide adequate protection for IP's retail customers so that litigation
21 expenses will be met outside of IP's transmission and distribution cost of service. This
22 guarantee from Ameren, and/or a financial set aside, will help protect IP's financial
23 condition in the future, thus minimizing retail ratepayers' risk of ultimately assuming the
24 responsibility for this liability.

1 **Q PLEASE EXPLAIN WHY YOU BELIEVE THE HMAC RIDER WILL SUBSIDIZE NON-**
2 **UTILITY OPERATIONS?**

3 **A**Asbestos litigation expenses are currently a liability created by IP's previous ownership
4 of generating assets. As noted above, IP can service this obligation with interest
5 payments and principal receipts produced from its affiliate loan asset, which was
6 compensation for IP for transferring its fossil generating units to Dynegy. Accordingly,
7 asbestos litigation is a liability tied to IP's affiliate loan asset, which is associated with
8 non-utility operations. By eliminating the affiliate loan asset and retaining related affiliate
9 loan liabilities, IP would enhance the value of its affiliate loan asset. This loan value
10 enhancement is created by the transfer of the asbestos liability to retail customers.
11 Therefore, I believe the HMAC rider will subsidize non-utility operations.

12 **REGULATORY ASSET**

13 **Q PLEASE SUMMARIZE APPLICANTS' WITNESS BAXTER'S REBUTTAL TESTIMONY**
14 **CONCERNING THE PROPOSED REGULATORY ASSET.**

15 **A**Mr. Baxter states that the Company is seeking to recover \$67 million of transaction costs
16 amortized over the period 2007 through 2010. This \$67 million would be treated as a
17 regulatory asset for ratemaking purposes. He argues that this is less than 15% of the
18 \$450 million total transaction cost the company incurs in this deal. He argues that
19 recovery of the regulatory asset is critical in closing the transaction because it is part of
20 the cost benefit tradeoff Ameren is willing to assume to consummate the transaction. He
21 concludes that without recognition of the \$67 million of regulatory assets in IP's rates,
22 Ameren will not close.

Q PLEASE COMMENT.

A Recovery of the regulatory asset as proposed by the Company is not appropriate for the following reasons. First, the Company should explicitly disclose the costs it is seeking to recover through rates. The Company identifies numerous types of transaction-related costs, but it is not possible to comment on the appropriateness of transaction cost recovery without clearly disclosing the cost requested for recovery.

Second, it is inappropriate to recover the regulatory assets in combination with elimination of IP's deferred income taxes. The combination of these two acquisition-related costs far exceed the acquisition benefits to customers. Therefore, it is not in the public interest to allow recovery of transaction costs to the extent the costs exceed the transaction benefits.

Q DID APPLICANTS' WITNESS MARTIN LYONS PROVIDE A SCHEDULE SHOWING SPECIFIC ALLOCATED TRANSACTION-RELATED COSTS WHICH COULD BE REFERENCED BY THE COMMISSION IN SUPPORT OF THE COMPANY'S REQUEST TO RECOVER \$67 MILLION OF REGULATORY ASSETS?

A Yes. Mr. Lyons sets forth on his Applicants' Exhibit 24.1, a breakout and allocation of the transaction-related costs which could be referenced by the Commission in support of the Company's request for regulatory assets of \$67 million to be amortized over four years starting in 2007. Note, I have already addressed recovery of many of these costs in my direct testimony.

However, I would note that included in the \$137 million of recoverable costs, identified by Mr. Lyons, is \$74.6 million of debt redemption premiums. The debt redemption premiums should be allocated entirely to elimination of the affiliate loan agreement, a non-regulated asset, and not to regulated utility operations. An important

1 objective of the proposed reorganization is to better match IP's capital with its net
2 investment in utility plant. Currently, there is a significant discrepancy between IP's
3 capital and utility plant due to the value of the affiliate loan agreement. That affiliate loan
4 agreement was provided to IP from Dynegy in lieu of a cash payment for IP's non-
5 nuclear generating assets. Consequently, IP could not retire debt that was previously
6 supporting its non-nuclear generating assets, because it was not provided cash in the
7 generation asset transfer transaction. Consequently, any debt redemption associated
8 with retiring debt which had previously supported such generating assets, and is now
9 supporting the affiliate loan agreement asset, should not be amortized to retail
10 transmission and distribution customers.

11 **Q HOW MUCH OF THE TRANSACTION COST IDENTIFIED BY MR. LYONS SHOULD**
12 **BE SUBJECT TO RECOVERY IF OFFSET BY TRANSACTION SAVINGS?**

13 **A** If \$74.6 million is eliminated from \$137 million the Company is allocating to IP retail
14 operations, the amount remaining would be \$62.4 million. This remaining amount
15 should be amortized starting at January 1, 2005. If it was amortized over seven years,
16 the amount remaining to be amortized at January 1, 2007 would be \$44.6 million.
17 Consequently, I would recommend the Commission consider amortizing no more than
18 \$44.6 million as a regulatory asset to IP's retail utility operations if recovery of
19 transaction costs is approved as part of the transaction.

20 **Q DID APPLICANTS' WITNESS NELSON ADDRESS THE COST BENEFIT**
21 **RELATIONSHIP UNDER THE PROPOSED REORGANIZATION IN HIS REBUTTAL**
22 **TESTIMONY?**

1 A Yes. On Mr. Nelson's Exhibit 23.1, Case A and Case B, he again compares the revenue
2 requirement of IP under Ameren ownership and under Dynegy ownership. Again,
3 excluding claimed purchased power and gas cost savings, the proposed reorganization
4 will have a negative impact by increasing IP's delivery service rates, as illustrated by a
5 comparison of "Gross Margin" under Case A and Case B under Ameren ownership,
6 compared to the gross margin under the Dynegy ownership. What Mr. Nelson refers to
7 as the "Gross Margin" is essentially IP's revenue requirement excluding purchased
8 power and gas costs. Note, that Mr. Nelson has included additional savings estimates in
9 his updated analysis.

10 **Q DID MR. NELSON'S UPDATED ANALYSIS SHOW WHETHER THERE WOULD BE A**
11 **DETRIMENTAL RATE IMPACT FOR IP'S CUSTOMERS THAT DID NOT PROCURE**
12 **GAS AND POWER SUPPLY FROM IP?**

13 A Mr. Nelson's updated analysis still shows there will be a significant negative rate impact
14 for IP's customers that do not procure gas and purchased power from IP. In Mr.
15 Nelson's scenario, IP's revenue requirement, excluding gas and purchased power costs,
16 will increase under the proposed transactions, thus creating severe negative rate
17 impacts for IP customers that do not procure commodities from IP.

18 **Q HAS MR. NELSON RESPONDED TO YOUR ARGUMENT THAT THE COMMISSION**
19 **SHOULD CONSIDER THE REVENUE REQUIREMENT IMPACT UNDER AMEREN**
20 **AND DYNEGY OWNERSHIP, INCLUDING THE APPLICANTS' CLAIM OF REDUCED**
21 **GAS AND PURCHASED POWER COSTS.**

22 A Mr. Nelson argues that customers that do not procure gas and purchased power from IP
23 will benefit by the proposed transactions, because marketers will consider IP's tariff rate

1 options for power purchase and gas procurement from IP as a ceiling rate that could be
2 offered to customers who undertake competitive solicitations for these commodities.
3 Such indirect benefits, if they are in fact realistic possibilities, which for the reasons
4 stated below they are not, do not meet the "no adverse rate impact standard." The rates
5 in question are IP's delivery service rates, which will increase significantly under the
6 Applicants proposal. Mr. Nelson's argument does not address that issue directly.

7 Furthermore his premise that customers will benefit because competitors will
8 have a lower price to beat, assumes these customers will always be entitled to take
9 bundled service from IP. This is wrong for at least three reasons. First, because of the
10 onerous terms and conditions for taking IP's bundled service (e.g., a five-year mandatory
11 commitment for a customer choosing, or returning to IP's SC 24), these bundled rates do
12 not provide an effective price ceiling. Second, it is my general understanding that at
13 least as to electricity this may not be the case going forward. Utilities apparently have
14 the right to declare electric service they offer competitive and then customers are denied
15 the opportunity to take the service thereafter. Third, no one currently knows the level or
16 even structure of utility rates after 2006. In addition if rates are ultimately set to give
17 competitors headroom to compete, the benefits Mr. Nelson alleges will accrue to these
18 customers will not accrue at all.

19 **Q HAS MR. NELSON ADEQUATELY DEMONSTRATED THAT IP'S ABILITY TO**
20 **PROCURE POWER AND GAS UNDER AN AMEREN OWNERSHIP SCENARIO IS**
21 **BETTER THAN UNDER A DYNEGY OWNERSHIP SCENARIO?**

22 **A** In my opinion, no. While there may or may not be economies of scale that could benefit
23 IP in commodity procurement, Mr. Nelson has simply not adequately demonstrated that
24 his representations will be backed up by lower commodity costs. Further, Mr. Nelson

1 still continues to substantially overstate the cost of IP's poor credit rating on commodity
2 procurement costs, as I described in my direct testimony. For these reasons, Mr.
3 Nelson's estimated power procurement and gas procurement cost savings under the
4 Ameren ownership scenario are not reasonable and therefore the savings estimates are
5 not reliable.

6 **CAPITAL STRUCTURE**

7 **Q ARE THERE OTHER PORTIONS OF THE APPLICANTS' REBUTTAL TESTIMONY**
8 **TO WHICH YOU WOULD LIKE TO RESPOND?**

9 A Yes. Ameren witness Jerre Birdsong makes two arguments to which I would like to
10 respond. First, Mr. Birdsong responds to my contention that the Company's proposal for
11 a 50% to 60% common equity ratio of total capital is too expensive and not necessary to
12 maintain an investment grade bond rating at IP. Mr. Birdsong asserts that I did not use
13 enough financial information to reach such a conclusion, and specifically did not rely on
14 cash metrics to support my analysis.

15 Second, Mr. Birdsong responds to my argument that the Company's cost of
16 common stock issuance expense should be amortized among all of Ameren's
17 companies, and not recovered only from IP customers. Mr. Birdsong contends that the
18 Company's equity issuances in February and July of 2004 produced cash proceeds that
19 are being used solely for its acquisition of IP. He argues that this common equity
20 issuance has not benefited any other Ameren affiliate and therefore these costs should
21 be recovered from only IP utility customers.

Q PLEASE RESPOND TO MR. BIRDSONG'S ARGUMENTS.

A First, Mr. Birdsong appears to refuse to acknowledge the existence of credit rating guidelines published by Standard & Poor's which provide guidance to review the reasonableness of Ameren's proposed capital structure for IP. Standard & Poor's publishes ratings guidelines, including total debt to total capitalization ratios reflecting the Company's business risk and financial strength. As addressed in my direct testimony, based on Standard & Poor's guidelines, IP does not need to maintain a capital structure composed of 50% to 60% common equity to support an investment grade bond rating.

Mr. Birdsong's refusal to recognize the reasonableness of relying on S&P's published financial utility credit rating financial benchmarks to review the reasonableness of Ameren's proposed capital structure and cost of service for IP under Ameren's ownership is without merit. Standard & Poor's published benchmarks provide independent and relevant information to review the reasonableness of Ameren's proposed cost structure for IP.

Q SHOULD YOU HAVE DONE A DETAILED REVIEW OF IP'S CASH FLOW METRICS IN SUPPORTING YOUR CAPITAL STRUCTURE RECOMMENDATION AS ADVOCATED BY MR. BIRDSONG?

A No. The cash flow metrics evaluation in the capital structures are somewhat inter-related, but yet distinctly separate from reviewing the reasonableness of Ameren's proposed capital structure for IP.

While cash metrics are an important element in determining a bond rating, they are different, although interrelated, from the review of an appropriate and reasonable capital structure. Cash metrics are driven by a fair and reasonable return on common equity, depreciation rates and amortization schedules. All of these are important factors.

1 They will be dealt with in IP's next rate proceeding, but they are not at issue in this
2 proceeding. Therefore, a review of IP's cash metrics was not necessary in order to
3 review and comment on the reasonableness of Ameren's proposed capital structure for
4 IP.

5 In any event, contrary to Mr. Birdsong's contention, Standard & Poor's financial
6 ratio benchmarks are an independent and credible source that can be used to fairly and
7 accurately judge the reasonableness of Ameren's proposed capital structure for IP. Mr.
8 Birdsong's contention that Standard & Poor's published financial benchmark guidelines
9 should be ignored is completely without merit, is contrary to prior Commission practice,
10 and should be firmly rejected by the Commission.

11 **Q IS THERE ANY MERIT TO MR. BIRDSONG'S CONTENTION THAT AMEREN'S**
12 **PROPOSAL TO FUND ITS IP ACQUISITION BY ISSUANCE OF PREDOMINATELY**
13 **COMMON EQUITY DOES NOT BENEFIT OTHER AMEREN AFFILIATES?**

14 **A** No. In fact, Mr. Birdsong's argument is in conflict with other Applicants witnesses'
15 testimony. Specifically, Ameren witness Baxter asserts that Ameren's proposed capital
16 structure for IP is designed to improve IP's bond rating to investment grade, and to
17 protect the existing bond ratings of other Ameren affiliates (Applicants' Exhibit 21.0 at 3).
18 Consequently, Ameren's proposed funding source and IP's capital structure is
19 specifically designed to benefit all Ameren affiliates, including IP. Consequently, it is
20 appropriate to allocate the cost of the common equity issuances among all Ameren
21 companies, not only IP.

1 **Q DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

2 **A Yes, it does.**

MPG:cs/8191/48618